

Message Text

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ACTION AID-59

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FM AMEMBASSY VIENTIANE

TO SECSTATE WASHDC 3029

C O N F I D E N T I A L VIENTIANE 1880

AIDAC

FOR NOOTER FROM MANN

E. O. 11652: GDS

SUBJECT: FEOF AGREEMENTS

REFERENCES: A. STATE 45595

B. VIENTIANE 1802

C. STATE 44848

D. VIENTIANE 1770

E. STATE 44370

F. VIENTIANE 1609

G. STATE 39704

H. VIENTIANE 1542

BEGIN SUMMARY. GIVEN BELOW ARE REASONS WHY NIB CEILINGS
WERE OMITTED FROM PARA VIII. B.2. OF CONFIDENTIAL LETTER.
END SUMMARY.

1. WELCOME OPPTUNITY TO CLARIFY AND SUPPLEMENT VIEWS
EXPRESSED IN OUR RECENT MESSAGES WHY I CONSIDERED
REINTRODUCTION OF NIB CEILINGS IN PARA VIII. B.2. OF
CONFIDENTIAL LETTER INADVISABLE AND WHY REFERENCE TO
NIB CEILINGS WAS OMITTED FROM THAT PARA IN THE FIRST PLACE.

2. ASIDE FROM TIME CONSTRAINT AND INADVISABILITY OF
REOPENING ISSUE WHICH HAD BEEN DISCUSSED AND AGREED UPON BY
DONORS, THE BASIC REASON FOR NOT INCLUDING REFERENCE TO NIB
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CEILINGS IN PARA VIII. B.2. IS THAT ADJUSTMENT OF EXCHANGE
RATE MAY NOT BE THE APPROPRIATE REMEDY IF THESE CEILINGS

ARE BREACHED NOR COULD IT BE CARRIED OUT WITHIN 5 DAYS AFTER CEILINGS ARE EXCEEDED. THUS RETENTION OF NIB CEILINGS IN PARA WOULD IN MY VIEW WEAKEN ITS INTENT. I. E. TO PROVIDE FOR A SEMI- AUTOMATIC SANCTION WHICH CAN BE PUT INTO EFFECT WITHIN 5 DAYS. IN OTHER WORDS WE DO NOT WANT TO INCLUDE SANCTIONS AND REMEDIES IN THE AGREEMENTS WHICH ARE NOT CREDIBLE LEST WE WEAKEN RLG DETERMINATION TO COMPLY CLOSELY WITH THE PROVISIONS OF THE AGREEMENTS.

3. BELIEVE INTENT OF PARA VIII. B.2 BECOMES CLEAR IF IT IS READ IN CONJUNCTION WITH PARA VIII. B.1. WHICH ESTABLISHES QUARTERLY CEILINGS ON FEOF DRAWINGS IN ORDER TO ASSURE THAT FEOF RESOURCES ARE ADEQUATE THROUGHOUT THE YEAR. IN ORDER TO UNDERSCORE IMPORTANCE WHICH DONORS ATTACH TO OBSERVANCE OF THESE CEILINGS AND AVOID PROTRACTED ARGUMENTS ABOUT REMEDIAL MEASURES WHICH RLG HAD TO TAKE IF THEY ARE EXCEEDED, PARA VIII. B.2. OF 1972 AGREEMENTS PROVIDED FOR A SPECIFIC SEMI- AUTOMATIC REMEDY, I. E. THE INSTITUTION OF A FLOATING RATE WITHIN FIVE DAYS.

4. IN REVIEWING THIS PARA IN CONNECTION WITH PREPARATION OF DRAFTS OF CY 1973 AGREEMENTS IT BECAME EVIDENT THAT WHILE ADJUSTMENT OF EXCHANGE RATE WITHIN 5 DAYS IS A MEANINGFUL AND EFFECTIVE DETERRENT IN CASE DRAWINGS ON FEOF (WHICH ARE VERIFIED ON A DAILY BASIS) EXCEED THE QUARTERLY CEILING, AN ADJUSTMENT OF THE EXCHANGE RATE WAS NOT NECESSARILY THE APPROPRIATE REMEDY IN CASE OF A BREACH OF NIB CEILINGS NOR COULD IT BE MEANINGFULLY ENFORCED WITHIN 5 WORKING DAYS. THUS LEAVING REFERENCE TO NIB CEILINGS IN THIS PARA MIGHT HAVE PUT INTO QUESTION DETERMINATION OF DONORS TO STRICTLY ENFORCE REMEDY, I. E. ADJUSTMENT OF THE EXCHANGE RATE WITHIN 5 DAYS, IN EITHER CASE.

5. BOTH TECHNICAL AND SUBSTANTIVE CONSIDERATIONS APPEARED TO ME TO FULLY SUPPORT THIS CONCERN.

A. WHILE DRAWINGS ON FEOF ARE MONITORED ON A DAILY BASIS AND THEREFORE BREACHING OF CEILINGS CAN BE DETECTED IMMEDIATELY AND EXCHANGE RATE ADJUSTMENT CARRIED OUT WITHIN 5 WORKING DAYS, THIS IS NOT POSSIBLE IN CONNECTION
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WITH NIB CEILINGS. WHETHER OR NOT NIB CEILINGS HAVE BEEN EXCEEDED CANNOT BE DETERMINED UNTIL SEVERAL WEEKS AFTER THE END OF THE QUARTER TO WHICH THEY APPLY. IF INFRACTION IS MINOR EXCHANGE RATE ADJUSTMENT WOULD UNDER ANY CIRCUMSTANCES BE A DISPROPORTIONATE REMEDY NOR COULD THE 5- DAY TIME-LIMIT FOR TAKING ACTION BE TIED CLEARLY TO A GIVEN STARTING DATE. THUS LANGUAGE IN PARA VIII. B.2. OF THE 1972 AGREEMENTS QUOTE OR THE NET INFLATIONARY BORROWING OF THE ROYAL LAO GOVERNMENT REACH THE PRESCRIBED CEILING BEFORE

THE END OF THE PERIOD TO WHICH IT APPLIES UNQUOTE DOES NOT
TAKE ACCOUNT OF THE REALITIES OF THE SITUATION.

B. FROM A SUBSTANTIVE POINT OF VIEW ADJUSTMENT OF THE
EXCHANGE RATE MAY NOT BE THE APPROPRIATE REMEDY FOR A BREACH
IN NIB CEILINGS, PARTICULARLY IF THERE IS NO EVIDENCE AT THE
TIME THAT THERE IS AN EXCESSIVE DEMAND PRESSURE ON FEOF
RESOURCES. SINCE THERE IS NO CLOSE SHORT- RUN CORRECTION
BETWEEN EXPANSION OF MS AND DEMAND FOR FOREIGN EXCHANGE
OTHER REMEDIES WOULD SEEM MORE APPROPRIATE UNLESS EXCESSIVE
EXPANSION IN MS IS RELECTED IN HEAVY DEMAND PRESSURE FOR
FOREIGN EXCHANGE. MORE APPROPRIATE REMEDY FOR BREACHING
NIB CEILINGS WOULD APPEAR TO BE MEASURES DESIGNED TO
REDUCE EXPENDITURES OR INCREASE REVENUES WHICH, HOWEVER,
WILL TAKE SOME TIME TO IMPLEMENT AND BECOME EFFECTIVE. IN
THIS CONNECTION PARA I. A. OF OPEN LETTER WHICH REFERS TO
TAKING NECESSARY FISCAL MEASURES ON AN URGENT BASIS IN
ORDER TO LIMIT NIB WOULD APPEAR TO FOCUS ON THE PROPER
REMEDY. MONTC EXAMINATIONS OF THE PROGRESS OF THE
STABILIZATION PROGRAM BY THE SCC (PARA IV. B. OF
OPEN LETTER) WOULD APPEAR TO PROVIDE THE PROPER FORUM FOR
CONSIDERING BREACHES IN NIB CEILINGS AND APPROPRIATE
REMEDIES.

6. WITH RESPECT TO YOUR CONCERN EXPRESSED IN REF C THAT
DROPPING NIB CEILINGS IN PARA VIII. B.2. WOULD UNDERMINE
IMF EFFORTS HERE, I HAVE, AS REPORTED IN REF B, QUERIED
IMF REP BAER ON THIS. I SHOULD ALSO LIKE TO REFER TO
EXCHANGE OF MESSAGES LAST OCTOBER WHEN IMF RES REP
SCHELZIG THOUGHT THAT QUARTERLY SEP 30 NIB CEILING WOULD
BE EXCEEDED. IN STATE 180847, PARA 3 WASHINGTON STATED
QUOTE THIS MESSAGE IS INTENDED TO ASSURE THAT RATE IS NOT
AUTOMATICALLY FLOATED, EVEN IF NIB CEILING IS EXCEEDED
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UNQUOTE. IN VIENTIANE 7490, PARA 3 WE ASSURED WASHINGTON
THAT THERE WAS NO INTENTION HERE TO BRING ABOUT FLOATING
RATE FOR A MINOR BREACH OF NIB CEILINGS. THIS EXCHANGE
APPEARED TO ME TO CONFIRM MY VIEW THAT THERE WAS NO
INTENTION TO ENFORCE AN ADJUSTMENT OF EXCHANGE RATES IN
CONNECTION WITH BREACHING OF NIB CEILINGS, THUS RAISING
QUESTION WHETHER PARA AS WORDED WAS REALISTIC.
LIKEWISE IN REPORTING ON DISCUSSIONS WITH PALMER ON
DEC 6 (STATE 226607, PARA 4) WASHINGTON STATED THAT IN
PALMER' S VIEW THERE SHOULD BE NO PROVISION IN AGREE-
MENT FOR EXCHANGE RATE ADJUSTMENT AS RESULT OF EXCEEDING
NIB CEILINGS.

7. AS FURTHER EVIDENCE THAT I HAVE HAD NO REASON TO BELIEVE
THAT WASHINGTON OBJECTED TO OMISSION OF NIB CEILINGS
FROM PARA VIII. B.2. , I SHOULD LIKE TO MENTION THAT IN

VIENTIANE 1196 ON FEB 16 WE REPORTED ALL PROPOSED AMENDMENTS TO 72 AGREEMENTS AND INCLUDED THE PRESENT WORDING OF PARA VIII. B.2., AND IN VIENTIANE 1209 WE CABLED THE FULL TEXT OF THE CONFIDENTIAL LETTER. NOT UNTIL STATE 39704 OF MAR 3, AFTER WE REPORTED AUSTRALIAN SUBMISSION AND WITHDRAWAL OF THEIR AMENDMENTS, DID WASHINGTON STATE THAT IT FAVORED INCLUSION OF NIB CEILINGS IN PARA VIII. B.2.

8. HOPE THAT THESE EXPLANATIONS AND BACKGROUND WILL HELP TO CLARIFY REASONS FOR NOT INCLUDING NIB CEILINGS IN PARA VIII. B.2. WOULD LIKE TO REITERATE MOST STRONGLY THAT THERE IS NO INTENTION ON OUR PART AND OTHER DONORS TO WEAKEN INSISTENCE ON OBSERVANCE OF NIB CEILINGS, BUT BELIEVE THAT OTHER, I. E. FISCAL MEASURES WOULD BE A MORE APPROPRIATE REMEDY AND INCLUSION OF REFERENCE TO NIB CEILINGS IN PARA VIII. B.2. WOULD WEAKEN EMPHASIS ON EXCHANGE RATE ADJUSTMENT AS AN APPROPRIATE REMEDY IN CASE CEILINGS ON FEOF DRAWINGS ARE EXCEEDED.
GODLEY

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